

## INFORMATION PAPER

DAJA-LA  
19 June 2000

SUBJECT: Taxation of Military Pay(s) Received in Retirement

1. Purpose. To provide information about the taxation of pay that may be received rescheduled from 19 June after retirement.

2. Facts.

a. Military retired/retainer pay is subject to federal income taxation and may be subject to taxation at the state level. Additionally, you may be required to pay an ad valorem tax on certain personal property in your state of legal residence.

(1) Under the Soldiers' and Sailors' Civil Relief Act (SSCRA) your active duty military pay has been subject to taxation by only the federal government and your state of domicile. Upon retirement your military retirement pay is no longer protected under the SSCRA.

(2) Also, while on active duty, you have only been subject to ad valorem taxes in your state of domicile. For example, if you are not a domiciliary of Virginia while on active duty, and you continue to reside in Virginia upon retirement, you must change the registration on your vehicle to Virginia "resident" and pay the personal property taxes on it. As a retiree you will no longer receive the protections of the SSCRA regarding ad valorem (personal property) taxes.

(3) If you change your state of domicile upon retirement your pay will be subject to taxation under the laws of that state. To avoid subjecting active duty pay you have already received to back taxes in your new state domicile, delay taking actions such as registering to vote, getting a driver's license, changing your will to recognize your new domicile, or establishing other contacts with your new state, until after retirement.

b. Disability compensation paid by the Veterans Administration (VA) to people with service-connected disabilities is exempt from income tax.

(1) To receive VA compensation a military retiree must waive payment of an equal amount of military retired pay. This VA compensation includes the additional amount payable on behalf of dependents for veterans with a disability rating of 30 percent or higher. Accordingly, the receipt of VA compensation reduces taxable retired pay but only by the amount of the VA award. The percentage or degree of disability

DAJA-LA

SUBJECT: Taxation of Military Pay(s) Received in Retirement

assigned by the VA does not exempt the same percentage of military retired pay from income tax, as is the case with a military disability rating.

(2) For military disability retirees who elect to receive VA compensation, the waiver of military retired pay is applied first to the nontaxable portion of retired pay since a dual tax benefit is not allowed for the same disability. Accordingly, there is no tax benefit to a disability retiree from a VA disability award unless the amount of VA compensation exceeds the nontaxable portion of military disability retired pay.

(3) Normally, a few months elapse between the effective date of a VA disability rating and the date the waiver of retired pay is processed by the Defense Finance and Accounting Service Center, or respective pay center, reducing taxable military retired pay. To receive the tax benefit for the interim period in this situation, the retiree should reduce taxable military retired pay (as reported on Form 1099-R) by the dollar amount of VA compensation that would have been payable had military retired pay been properly reduced during such a period. A brief explanation of the adjustment with a copy of the VA disability award certification should be attached to Form 1040, citing 38 U.S. Code, Section 5301, and IRS Ruling 78-161 as the authority. This procedure also can be followed for retroactive receipt of a VA disability rating; however, since a statute of limitations for such tax relief is not addressed in either reference, the three-year statute of limitations embodied in 26 U.S. Code, Section 6511(d), applies.

c. Military Disability Retired Pay may be exempt from federal and state income taxation.

(1) A person who is retired for military disability (as distinguished from non-disability retirement based on length of service) and has military pay based on percentage of disability must meet the following conditions for federal income tax exemption:

(a) On or before Sept. 24, 1975, the member was entitled to receive retired pay computed on the basis of percentage of disability;

(b) on Sept. 24, 1975, he or she was a member of the armed forces (or reserve component thereof) or under a binding written commitment to become such a member; or

(c) the member receives disability retired pay because of a combat-related injury. The term "combat-related injury" means personal injury or sickness incurred as a direct result of armed conflict, or while engaged in extra-hazardous

DAJA-LA

SUBJECT: Taxation of Military Pay(s) Received in Retirement

service, or under conditions simulating war or an instrumentality of war (26 U.S. Code, Section 104).

(2) For people covered under a, b, or c above, the tax-exemption rules are further clarified as follows:

(a) If military retired pay is based on the percentage or degree of disability or is paid under disability retirement laws in effect before Oct. 1, 1949, the entire amount is exempt from income tax; and

(b) where gross military retired pay is based on years of service (2.5 percent for each year), the amount payable solely on percentage of disability is tax-exempt. The excess, as reported on Form 1 099-R, is taxable income.

(3) For people not covered by the previously specified eligibility criteria- that is, primarily people who became members of the armed forces after Sept. 24, 1975, and who do not receive disability retired pay because of a combat-related injury or who are not eligible for disability compensation administered by the Department of Veterans Affairs-amounts received as disability retired pay are fully subject to taxation.

(4) The basics of federal taxation of military disability retired pay are depicted below:

#### FEDERAL TAX -- MILITARY DISABILITY RETIRED PAY

##### Disability Portion -- Length-Of -Service Pay:

- Member On 24 Sep 75 - No Tax
- Not A Member On 24 Sep 75 - Taxed

##### Retired Pay Based Solely On Disability:

- Member On 24 Sep 75 - No Tax
- Not A Member On 24 Sep 75 - Taxed, Unless
  - All Pay Based On Disability
  - Disability Result Of Armed Conflict, Extra-Hazardous Service, Simulated War, Or And Instrumentality Of War.

DAJA-LA

SUBJECT: Taxation of Military Pay(s) Received in Retirement

d. A table discussing types of pay and tax treatment by each state is provided for quick reference.

**TABLE OF TAXABILITY OF VARIOUS MILITARY RETIRED PAYS<sup>1</sup>**

STATE	NO INCOME TAX	MILITARY RETIRED PAY EXEMPT <sup>2</sup>	MILITARY DISABILITY PAY EXEMPT	STATE	NO INCOME TAX	MILITARY RETIRED PAY EXEMPT	MILITARY DISABILITY PAY EXEMPT
Ala		X		Mont			X
Alaska	X			Neb			X
Ariz			X	Nev	X		
Ark			X	NH	X		
Calif			X	NJ		X	
Colo			X	NM			X
Conn			X	NY		X	
Del			X	NC			X
DC			X	ND			X
Fla	X			Ohio			X
Ga			X	Okla			X
Hawaii		X		Ore			X
Idaho			X	PA		X	
Ill		X		PR			X
Ind			X	RI			X
Iowa			X	SC			X
Kan		X		SD	X		
Ky		X		Tenn	X		
La		X		Texas	X		
Maine			X	Utah			X
Md			X	VT			X
Mass		X		VA			X
Mich		X		Wash	X		
Minn			X	WV			X
Miss		X		Wis		X	
Mo			X	Wyo	X		

<sup>1</sup> This table provides general guidance only. The laws of each state should be consulted.

<sup>2</sup> If exempt at the Federal level

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